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In the Supreme Court of the United States

OCTOBER TERM, 1966

UNITED STATES OF AMERICA, PETITIONER

v.

THE CITIZENS NATIONAL BANK OF EVANSVILLE, AS EXECUTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The findings of fact and conclusions of law of the district court (R. 28–32) [1] are not officially reported. The opinion of the court of appeals (App. A, *infra*, pp. 13–21) is reported at 359 F. 2d 817.

JURISDICTION

The judgment of the court of appeals was entered on March 31, 1966 (App. A, *infra*, p. 22). By order of Mr. Justice Clark the time for filing a petition for a writ of certiorari was extended to and including

[1] "R." references are to Appendix B of the government's brief filed in the court of appeals.

August 28, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, contrary to an explicit Treasury Regulation, a bequest of property in trust providing for the monthly payment of a fixed dollar amount to the decedent's widow for her life constitutes a bequest of "all the income from a specific portion" of the trust property within the meaning of 1954 Code § 2056(b)(5) so as to qualify the bequest for a marital deduction.

STATUTES AND REGULATIONS INVOLVED

Sections 2056(a), (b)(1), (b)(5), and (c) of the Internal Revenue Code of 1954 and portions of Treasury Regulations (1954 Code), §§ 20.2056(b)–5(a), (b), (c), (d) and (f) are set forth in Appendix C, *infra*, pp. 47–55. The most pertinent portion of the statute, § 2056(b)(5), provides that:

> [i]n the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse * * *

the interest or such portion thereof shall qualify for the marital deduction.

STATEMENT

G. Ashburn Koch (the decedent) died testate on September 25, 1959, survived by his widow and two daughters. The residuary trust created by his will (of which respondent was the trustee) provided in part as follows:

> In the event I die prior to October 1, 1961, I direct my Trustee to pay to my wife the sum of Two Hundred Dollars ($200.00) per month up to and through December 1, 1964, and then to pay to my wife the sum of Three Hundred Dollars ($300.00) per month after December 1, 1964, each and every month for the duration of her life. * * * Provided, however, anything hereinbefore set out notwithstanding I order and direct that my wife, Mary Jane Koch, shall never receive less than the income produced from the corpus of my trust estate on and after December 1, 1964.

The Trustee was authorized to invade corpus if necessary to maintain the specified monthly payments to decedent's wife and was instructed:

> * * * to invest my trust corpus as nearly as may be possible so that one-half of my trust estate is invested with income in mind, in keeping with safety of principal, and one-half of my trust estate is invested with security in mind, it being my desire that, if possible, my trust estate produce an income of at least four per cent (4%) per annum.

Decedent also gave his wife a general testamentary power of appointment over the trust corpus—*i.e.*, she had the power to appoint the residue to "her estate or to such persons or persons * * * as she may determine by her Last Will and Testament." (R. 17–19, 26–27.)

On decedent's estate tax return, respondent (his executor) reported an adjusted gross estate of $272,671. The sole issue involved in this case is whether the residuary trust, which amounts to approximately $123,500, qualifies in whole or in part for the marital deduction. The relevant Code section provides, in pertinent part, that where the widow has such a general power of appointment over the trust corpus, a marital deduction will be allowed if she is also "entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals." 1954 Code § 2056(b)(5). Although respondent has several times changed its method of computing the "specific portion" of the residuary trust which it claims qualifies for the marital deduction, its complaint alleges that $68,572 of the $123,500 residuary trust so qualifies. This amount was determined by computing the amount of corpus which would be necessary to produce an income of $200 per month if the trustee obtained a 3½ percent annual return on its assets (*i.e.*, $68,572 × 3½% = $2,400). (R. 14–15, 27–28, 30.)

The district court held that a part of the widow's interest in the trust qualified for the marital deduction because, the court found, she was "entitled [for life] to all the income from a specific portion" of the

trust. In reaching this result the court rejected the specific Treasury Regulation which defines "specific portion" as "a fractional or percentile share" of an interest in property. Treas. Regs. (1954 Code), § 20.2056(b)–5(c). The district court also approved respondent's method of computing the amount of the marital deduction—*i.e.*, it gave respondent a deduction for an amount of trust corpus ($68,572) which would produce $2,400 per year if the trust earned 3½ percent on its assets. The Court of Appeals for the Seventh Circuit affirmed, one judge dissenting. (R. 31; App. A, *infra*, pp. 13–21.)

REASONS FOR GRANTING THE WRIT

1. The instant decision is in direct conflict with the decision of the Court of Appeals for the Third Circuit in *Northeastern Pennsylvania National Bank & Trust Co.* v. *United States*, decided July 19, 1966 (reprinted in App. B, *infra*, pp. 23–46). The facts of the two cases are substantially identical. In both cases a decedent created a residuary trust under which his surviving spouse was to receive a fixed dollar amount of income per month with power in the trustee to invade corpus, if necessary, to meet the monthly payments.[2] The surviving spouse in each case had a general power of appointment over the remainder of the trust at her death. The question in each of the two cases was whether the estate was en-

[2] In the instant case, while the widow was entitled to all of the income from the trust after December 1, 1964, she was to receive only $200 per month for the first five years after her husband's death in September 1959, which was substantially less than the expected income of the trust.

titled to a marital deduction under Code § 2056(b)(5). In the instant case the Court of Appeals for the Seventh Circuit rejected the relevant Treasury Regulation and allowed the deduction, one judge dissenting.[3] By contrast, in the *Northeastern Pennsylvania National Bank & Trust* case, the Third Circuit, sitting *en banc,* reached a result consistent with the regulation and denied the claimed deduction, three judges dissenting. The Third Circuit's opinion explicitly recognized that its decision created a direct conflict with the instant decision of the Seventh Circuit. (App. B, *infra,* p. 38.) The Seventh Circuit held that the qualifying "specific portion" of the trust corpus could be computed by capitalizing the widow's fixed monthly payment at an arbitrarily-assumed annual yield of 3½ percent. The Third Circuit, on the other hand, concluded that no method of computation could identify any specific portion of trust assets from which the surviving spouse was entitled to all the income actually produced.

A large number of decedents seek to obtain the benefit of a marital deduction by bequeathing to their surviving spouses an income interest for life plus a general power of appointment. The Treasury Regulation here in question has presumably discouraged most estate planners from using bequests of a fixed amount of income plus a general power of appointment. The conflict among the circuits has created uncertainty about the tax consequences of such bequests.

[3] In reaching its result the Seventh Circuit relied upon *Gelb v. Commissioner*, 298 F. 2d 544 (C.A. 2), which, although factually distinguishable, does lend support to the instant decision of the Seventh Circuit.

In view of the obvious significance of the issue in the administration of the Internal Revenue laws, this Court should resolve the conflict.

2. We submit that the decision of the Seventh Circuit in the present case is erroneous. The language of the statute, the Congressional intent, the legislative history, and the Treasury Regulations all compel denial of the marital deduction in such circumstances.

Congress enacted the marital deduction provisions of the Code in 1948 to equalize the effect of estate taxes in community property and common law jurisdictions. See *United States* v. *Stapf*, 375 U.S. 118, 128; *Jackson* v. *United States*, 376 U.S. 503. Under a community property system, a married person owns—and thus his estate includes—only one half of the community property, the other half belonging to his surviving spouse. In order to approximate this result in common law States, Congress granted a marital deduction—of up to one half of the adjusted gross estate—for property bequeathed by the decedent to his surviving spouse. Since in community property States the widow owns one half of the community property outright, Congress required, in general, that a decedent in a common law State, in order to qualify for the marital deduction, must bequeath his widow an interest in his property equivalent to absolute ownership. See § 2056(b)(1).

Consistent with its objective of giving residents of common law States equality of tax treatment with residents of community property jurisdictions, Congress refused to allow any marital deduction where the decedent gave his wife only a life estate in his property. See § 2056(b)(1), (b)(5). Congress

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did, however, in 1948 specifically grant a marital deduction where the decedent creates a trust and the "surviving spouse is entitled for life to *all the income* from the corpus of the trust * * * with power in the surviving spouse to appoint *the entire corpus*" to herself or her estate.[4] In such a situation, since the widow was entitled to "all the income" from the trust, any increase or decrease in the trust's income would directly affect her income. Similarly, since she had the power "to appoint the entire corpus" to herself or her estate, any increase or decrease in the value of the trust assets would directly affect the amount of property over which she had a power of disposition. In these two important respects she was in exactly the same position as if she had owned the property outright. Congress decided that, where she had these incidents of ownership, she was for practical purposes "the virtual owner of the property" and should be so treated for marital deduction purposes. S. Rep. No. 1013, Part 2, 80th Cong., 2d Sess., p. 16.

Thus, under the original 1948 legislation creating the marital deduction, if a decedent left one-half of his property in one trust for the exclusive benefit of his widow—giving her all the income from this trust and a general power of appointment over the corpus—and the other one-half of his property in another trust for his children, he was entitled to a marital deduction with respect to the first trust. However, if a decedent left all of his property in a single trust,

[4] 1939 Code § 812(e)(1)(F), as added by § 361 of the Revenue Act of 1948, c. 168, 62 Stat. 117. (Emphasis added.)

giving his widow one-half of the income and a general power of appointment over one half of the corpus, his estate would receive no marital deduction at all, because his widow neither received "all the income from the corpus of the trust" nor had a general power "to appoint the entire corpus."[5] This result followed although the widow's rights would be almost exactly the same whether the decedent created one trust or two—she would receive one-half of the income from his estate and have a general power of appointment over one-half of his estate. In either event her income would rise and fall as the income from the trust increased or decreased and the amount of property over which she had a power of disposition would fluctuate as the value of the trust assets increased or decreased.

Recognizing that there was no good reason to require a decedent to create two separate trusts, Congress in 1954 amended the Code to allow a marital deduction where the decedent gave his widow "all the income from the entire interest, or *all the income from a specific portion thereof*" plus a general power "to appoint the entire interest, or *such specific portion.*"[6] 1954 Code § 2056(b)(5) (emphasis added).

[5] See *Estate of Shedd* v. *Commissioner*, 237 F. 2d 345 (C.A. 9), certiorari denied, 352 U.S. 1024; *Estate of Sweet* v. *Commissioner*, 234 F. 2d 401 (C.A. 10), certiorari denied, 352 U.S. 878; *Estate of Hoffenberg* v. *Commissioner*, 22 T.C. 1185, affirmed, 223 F. 2d 470 (C.A. 2); *Estate of Stallworth* v. *Commissioner*, 260 F. 2d 760 (C.A. 5).

[6] Congress in 1958 made this 1954 amendment retroactive to the original enactment of the marital deduction provision in 1948. Technical Amendments Act of 1958, § 93, P.L. 85-866, 72 Stat., 1668.

This statutory amendment removed the necessity for creating two separate trusts; it did not relax the requirement that the widow must be "the virtual owner of the property," *i.e.*, that the amount of her income and the amount of property covered by her power of appointment must depend directly on the trust's income and the value of its assets. By the amendment Congress intended to allow a marital deduction if the widow became "the virtual owner" (S. Rep. No. 1013, Part 2, 80th Cong., 2d Sess., p. 16) of "an undivided part of the property," such as where she received "the income from all or one-half of the trust property" plus a general power "to appoint all or such one-half of the trust property by will." H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 92, A. 319; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 125, 475. Therefore, after this 1954 amendment to the marital deduction provisions, the Treasury promulgated a Regulation providing that:

> A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. * * * [I]f the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible

interest. [Treas. Regs. (1954 Code), § 20.2056 (b)–5(c).]

This Regulation clearly carries out the Congressional mandate that the widow receive "all the income from a specific portion" of the property. For, where, as in the case at bar, the widow is given the right to receive only a fixed monthly payment from the trust, she will not receive "all the income from a specific portion" of the trust because, as the trust's income varies, the amount of trust assets required to produce the fixed monthly income will also vary. For example, if a testamentary trust provided that the surviving spouse was to receive $4,000 annually, it would require $100,000 of trust assets at an arbitrarily assumed rate of four percent yield to produce the necessary income. If the yield should rise the following year to five percent, only $80,000 of trust assets would be necessary to produce $4,000 of income. Thus, had the value of the widow's marital deduction been computed on the basis of an assumed four percent yield, an increase in the yield would mean that part of the corpus which qualified for the marital deduction was not actually providing income for the widow.

In allowing the marital deduction in the present case, the lower court rejected this explicit Treasury Regulation which requires that the widow participate in increases or decreases both in the income from and the value of the trust property and, thus, that she be "the virtual owner" of a specific portion of the property. The court read out of the statute the requirement that the widow receive "all of the income from a specific

portion" of the property. It in effect rewrote the statute to grant a marital deduction whenever the widow is entitled to any amount of income. For any bequest of a fixed dollar income always can be viewed as the income from whatever portion of the estate is required to produce such income on the basis of an arbitrarily-assumed rate of return.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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AUGUST 1966.

APPENDIX A

In the United States Court of Appeals for the Seventh Circuit

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NO. 15254 SEPTEMBER TERM, 1965—JANUARY SESSION, 1966

THE CITIZENS NATIONAL BANK OF EVANSVILLE, ET AL., AS EXECUTOR OF THE LAST WILL AND TESTAMENT OF G. ASHBURN KOCH, DECEASED, PLAINTIFF-APPELLEE,

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT.

Appeal from the United States District Court for the Southern District of Indiana

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March 31, 1966

Before KNOCH, CASTLE and KILEY, *Circuit Judges.*

KILEY, *Circuit Judge.* Plaintiff-Bank sued under 28 U.S.C. § 1346(a)(1) for refund of estate taxes paid after the District Director of Internal Revenue disallowed part of a marital deduction claimed in the estate tax return filed by the Bank by virtue of the INT. REV. CODE of 1954, § 2056. The district court held in favor of the Bank under § 2056(b)(5).[1] We affirm.

[1] This sub-section provides an exception to the "terminable interest" rule of § 2056(b)(1), for it provides in pertinent part

The deduction was claimed by the Bank as executor of decedent's will and trustee under a residuary trust in which the settlor-husband provided, so far as relevant here:

> (a) In the event I die prior to October 1, 1961, I direct my Trustee to pay to my wife the sum of Two Hundred Dollars ($200.00) per month up to and through December 1, 1964, and then to pay to my wife the sum of Three Hundred Dollars ($300.00) per month after December 1, 1964, each and every month for the duration of her life.

The widow was the sole trust beneficiary, the only person entitled to any income, and was given the general power to appoint the remainder of the trust by her last will and testament. Since the settlor died September 25, 1959, we are concerned only with the payments of $200.00 per month and whether these payments provide the widow with an interest in "all the income from a specific portion" of the entire interest, § 2056(b)(5), thus qualifying for the marital deduction. The part of the marital deduction based on the value of the trust estate created by the will was claimed by the executor, disallowed by the District Director, and after the Bank's claim for refund was disallowed, this suit followed.

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that the decedent's estate is entitled to the marital deduction to the extent that the surviving spouse "* * * is entitled for life to all the income from the entire interest, or *all the income from a specific portion thereof*, * * * with power in the surviving spouse to appoint the entire interest, or such specific portion. * * *" (Emphasis added.) This sub-section succeeded Int. Rev. Code of 1939, § 812(e), added by Revenue Act of 1948, § 361, but § 812(e)(1)(F) allowed the deduction only if the surviving spouse was entitled to "all" the income from the trust corpus.

The district court determined, by use of the annuity tables and directions promulgated by the Treasury Department,[2] that the widow was entitled, by virtue of the $200.00 monthly income provision under the trust, "to all of the income from a specific portion of the trust * * * in the amount of $68,572.00," and that this amount qualified as a marital deduction. That dollar amount is the sum which, at 3½% interest, should produce $200.00 income per month for the surviving spouse, according to actuarial computation. The court disapproved, as inconsistent with the statute, Treasury Regulation on Estate Tax (1954 Code), § 20.2056(b)–5(c),[3] relied on by the Government, in so far as it would limit the statutory term "specific portion" to "a fractional or percentile share."

A marital deduction equal in value to a maximum 50% of the adjusted gross estate is allowed for the value of any interest in property which passes from the decedent to the surviving spouse.[4] However, since

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[2] Treas. Reg. on Estate Tax § 20.2031–7, 8; 26 C.F.R. § 20.2031–7, 8 (1961).

[3] This section of the regulations provides in pertinent part:

> (c) Definition of specific portion. A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute *a fractional or percentile share* of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to one-half or a specified percentage of the property, or the equivalent, the interest is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest. (Emphasis added.)

26 C.F.R. § 20.2056(b)–5(c) (1961).

[4] Int. Rev. Code of 1954, § 2056(a), (c).

the widow's interest here is a right to a limited amount of income for the duration of her life, and therefore a "terminable interest,"[5] her interest under the trust before us is deductible only if her life interest is in "all the income from a specific portion" of the entire interest.[6] There is no claim that the 3½% rate applied was an improper rate.

The parties agree that the "sole issue * * * is whether the surviving spouse was entitled for life to all the income from a specific portion of the corpus of the trust," so as to come within the provisions of § 2056(b)(5). We hold that the surviving spouse was entitled for life to all the income "from a specific portion" of the corpus of the trust, and that the Bank was entitled to include that amount in the return filed as part of the claimed marital deduction.

The purpose of the marital deduction provision was to extend to spouses in common law states the advantages of married taxpayers in community property states, by permitting the surviving spouse to acquire free of estate tax up to one-half of the decedent's adjusted gross estate, *Dougherty* v. *United States*, 292 F.2d 331, 337 (6th Cir. 1961), and to bring about a two-stage payment of estate taxes, *United States* v. *Stapf*, 375 U.S. 118, 128 (1963). The "terminable interest" limitation was intended to prevent an escape from tax liability of the second step, *i.e.*, the passing of the surviving spouse's interest to "any other person" upon termination of her life estate or other terminable interest without estate or gift tax, *United States* v. *Stapf*, 375 U.S. at 128; *Dougherty* v. *United*

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[5] Int. Rev. Code of 1954, § 2056(b)(1). See Generally *Cunha's Estate* v. *C.I.R.*, 279 F.2d 292, 296 (9th Cir.), *cert. denied*, 364 U.S. 942 (1960) ("terminable interest," § 812(e) of 1939 Code).

[6] Int. Rev. Code of 1954, § 2056(b)(5); see note 1, *supra*.

States, 292 F.2d at 337; *Commissioner* v. *Ellis' Estate,* 252 F.2d 109, 112 (3rd Cir. 1958). By section 361 of the Revenue Act of 1948, Congress amended section 812(e) of the 1939 Code to introduce the marital deduction provision. But the result was a failure to cover the situation in which the surviving spouse "received less than all of the trust income or the power to appoint less than all of the trust property."[7] This legislative deficiency was remedied by Congress in section 2056(b)(5) of the 1954 Code, which excepts from the terminable interest rule a life estate in income from a "specific portion," with power to appoint that portion.

The qualification of the widow's interest for deduction must be determined as of the time of her husband's death. *Jackson* v. *United States,* 376 U.S. 503, 508 (1964). The Government argues that since the widow's estate is not a "fractional or percentile" part, required by Treasury Regulation § 20.2056(b)-5(c), it cannot be a "specific portion"; that the capitalized sum reached by the district court cannot be "specific" because the value of the entire trust corpus is subject to fluctuation due to economic conditions,[8] result-

[7] *Northeastern Pennsylvania Nat. B. & T. Co.* v. *United States,* 235 F.Supp. 941, 943 (M.D. Pa. 1964) See also note 1 *supra.*

[8] *I.e.,* a restricted amount, the $68,572.00, can never be a "specific portion" of a larger, variable amount, the trust corpus. Brief for the Appellant, pp. 17–18. The substance of this contention appears to have been made, and rejected, in the *Gelb Northeastern Pennsylvania Nat. Bank,* and *Allen* decisions discussed *infra.* Counsel for the Government, on oral argument here, conceded that if the surviving spouse were given a life interest in all the income from a restricted amount, *i.e.,* $68,572.00, plus the requisite power of appointment, this would qualify. While this may not concede the case, it does concede that a limited dollar amount (the capitalized sum here) may be

ing in a risk of tax loss to the Government in a period of economic deflation while, her income being constant, there is no risk to the widow of increased tax in an inflationary period; and that, even if the capitalized sum can be a "specific portion" of the corpus, the widow is not entitled to "all the income" from that portion, because (1) the will provides only that she receive $200.00 per month from the trust,[9] and in addition, permits invasion of corpus if necessary for these payments,[10] and (2) it cannot be said, or assumed, that the trust will have a uniform return on corpus of 3½% per year, which means the amount necessary to produce $200.00 per month will vary.

These theories, with the exception of the latter argument,[11] as well as the Government's arguments urged here on the legislative history of § 2056 and the provisions of regulation § 20.2056(b)-5(c), were rejected by the Second Circuit in *Gelb* v. *C.I.R.*, 298 F.2d 544, 549–52 (2nd Cir. 1962). There the wife was given a life interest in the "net income" and a general power of appointment by will over the remainder at her death, and the issue was whether a power, given to the trustees to invade corpus for a maximum of $5,000.00 per year for the support and education of a minor daughter, destroyed the marital deduction be-

a "specific portion," and within the "fractional or percentile share" terminology of the regulation.

[9] Appellee in its claim for refund alleged the trust had a value of $123,541.10.

[10] The trustee was also directed to pay "all costs, expenses, taxes and charges out of the income or corpus" before making distribution to the widow. Thus her payments might come from corpus.

[11] This argument was specifically made and rejected in *Northeastern Pennsylvania Nat. Bank*, see text accompanying note 12; the *Gelb* court inferentially rejects it by approving actuarially-computed "specific" portions.

cause the wife would not have the power to appoint the "entire interest" or a "specific portion" thereof. The court approved the use of actuarial tables to capitalize the sum needed to provide from corpus for the annual $5,000.00 invasionary power, and upheld the marital deduction under § 2056(b)(5) by subtracting the capitalized sum from the entire corpus to arrive at the "specific portion" of the corpus over which the widow had power to appoint. Specifically disapproved was regulation § 20.2056(b)-5(c) in so far as it would limit "specific portion" to "a fractional or percentile share." The court said that Congress would not "balk" at using the method to delineate a "specific portion" because of the widespread use of actuarial tables in solving estate tax problems.

A district court in *Northeastern Pennsylvania Nat. B. & T. Co.* v. *United States,* 235 F.Supp. 941 (M.D. Pa. 1964),[12] followed *Gelb* in giving the statutory term "specific portion" a broader meaning than that sought here by the Government. There the trustee was directed to pay the widow, from income and corpus, monthly payments for her life, and she was empowered to appoint any or all of the corpus remaining at her death. The trustee listed the value of the trust corpus which passed under the will as qualifying for a marital deduction. The deduction was disallowed. The Government there urged upon the court the same arguments that it urges here. Plaintiff contended that the widow was entitled to the deduction, at least to the extent of the value of the "specific portion" computed actuarially, since she alone received income payments and had the general power of appointment by will over the remainder at her death.

The court considered the Government argument that both the widow and Government should share equally

[12] *Appeal pending*, No. 15249, 3rd Cir., Oct., 1965.

in the risk of the fluctuation in value of the corpus resulting in decrease or increase in taxes, and that the "fractional or percentile share" requirement of the regulation must be met. The court, however, following *Gelb,* rejected the Government's arguments and computed actuarially the portion of the corpus which was needed to yield the widow's income and allowed the deduction accordingly. The court, 235 F. Supp. at 946, agreed with the reasoning in *Gelb,* 298 F.2d at 551, that the Congressional "* * * example of a 'specific portion' [as a fractional interest] does not warrant a construction that Congress did not mean to include other instances fairly within the language and the underlying policy."

In the recent case of *Allen* v. *United States,*[13] the widow was entitled to all the trust income for life, but was not expressly empowered to appoint any portion. She was, however, entitled to be paid from corpus on written request an amount "not to exceed" $5,000.00 annually. The Government's position was that the provision for the annual payments was not a power to appoint a specific portion because she was not given a power to appoint a "fractional or percentile" share. This court relied also upon *Gelb,* the "leading case on the subject," in qualifying for the deduction as a "specific portion" the $5,000.00 in question, a limited dollar amount which the Government contends does not fulfill the regulation or statute. The court noted that all courts which had examined "this particular problem" had rejected the Government position.

[13] Civil No. 64 C 402(2), E.D. Mo., Oct. 29, 1965.

No reason advanced has persuaded us that we can substantially distinguish the facts and underlying principles involved before us from those in *Gelb,* and none that we should not do substantially here what the Second Circuit did in *Gelb.* In this court the Government cites no decision in its favor on the issue here, adding only that "we respectfully submit, however, the *Gelb* decision is erroneous * * *." [14]

We are unable to agree with the Government's appraisal of *Gelb,* and the judgment is affirmed.

CASTLE, *Circuit Judge,* dissenting. The statutory language here involved (26 U.S.C.A. § 2056(b)(5)) "* * * entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, * * *" is without ambiguity. And, to qualify pursuant to this exception to the terminable-interest rule the quality of the interest passing to the surviving spouse must meet the standard Congress saw fit to impose. Something judicially rationalized as approximately equivalent is not enough. I believe it self-evident that the right to $200 a month for life is neither a right for life to all the income from the entire interest nor to all the income from a *specific* portion of the interest. Accordingly, I would reverse.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit.

[14] Brief for the Appellant, p. 20.

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

THURSDAY, MARCH 31, 1966

Before Win G. Knoch, Latham Castle, Roger J. Kiley, *Circuit Judges*

No. 15254

THE CITIZENS NATIONAL BANK OF EVANSVILLE, ET AL., AS EXECUTOR OF THE LAST WILL AND TESTAMENT OF G. ASHBURN KOCH, DECEASED, PLAINTIFF-APPELLEE,

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT.

Appeal from the United States District Court for the Southern District of Indiana, Evansville Division

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Indiana, Evansville Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.

APPENDIX B

United States Court of Appeals
For the Third Circuit

No. 15249

NORTHEASTERN PENNSYLVANIA NATIONAL BANK & TRUST COMPANY, EXECUTOR UNDER THE WILL OF CLARENCE C. YOUNG

v.

UNITED STATES OF AMERICA, APPELLANT

Appeal From the United States District Court for the Middle District of Pennsylvania

Argued October 18, 1965

Reargued June 9, 1966

Before STALEY, *Chief Judge,* and MCLAUGHLIN, KALODNER, HASTIE, FORMAN, GANEY, SMITH and FREEDMAN, *Circuit Judges*

OPINION OF THE COURT

(Filed July 19, 1966)

By FORMAN, *Circuit Judge.*

This is an appeal by the defendant, United States of America (hereinafter appellant) from a summary

229-532—66——4

judgment entered by the United States District Court for the Middle District of Pennsylvania on the motion of plaintiff, Northeastern Pennsylvania Bank and Trust Company, Executor under the will of Clarence C. Young (hereinafter appellee), in the amount of $17,574.45 with interest, and from the denial of appellant's motion for summary judgment. Appellee's suit alleged an improper rejection of a claimed marital deduction.

Decedent died testate on May 3, 1958 survived by his wife and four children. Paragraph 6 of decedent's will [1] provided for the bequest of one-half of the residue of the estate to appellee who was directed to pay out of income, and corpus if necessary, the sum of $300 per month to decedent's wife until his youngest

[1] "ITEM 6. I give, devise and bequeath one-half (½) of all the rest, residue and remainder of my estate, whatsoever and wheresoever the same may be, both real and personal, to which I may be entitled, or which I may have power to dispose of at the time of my death, unto my Trustee hereinafter named and designated, to have and to hold the same in trust, nevertheless, as hereinafter provided.

"(a) I direct my Trustee to pay out of the said income and corpus of the said estate unto my wife, Beatrice O. Young, the sum of Three Hundred Dollars ($300.00) per month for and during the period until my youngest child reaches the age of eighteen years, and thereafter I direct my Trustee to pay to my wife, Beatrice O. Young, the sum of Three Hundred Fifty Dollars ($350.00) per month for and during the rest of her natural life.

"(b) If my wife survives me, she shall have the power, exercisable by Will, to appoint to her estate, or to others, any or all of the principal remaining at the time of her death. If my wife fails to appoint the entire principal to her estate or to others as above authorized, then upon her death (or if she predeceases me, then upon my death) any principal remaining at that time shall be paid over to my children on the same terms and conditions as under Item 7 of this my Will."

child reached eighteen years of age, after which appellee was directed to pay decedent's wife $350 per month for the rest of her life. Paragraph 6 also provided that if decedent's wife survived him, she would have the power, exercisable by will, to appoint to her estate, or to others, any or all of the principal of the trust remaining at the time of her death. Paragraph 11 [2] recited that such stipends were in no event to be liable for any debts contracted by the survivor and were not to be liable to attachment or assignment, but were solely for the use, maintenance and support of the survivor.[3] Paragraph 11 also indicated that income produced from the corpus of the trust which exceeds the monthly allotment is to be accumulated. Paragraph 12 [4] of the will granted appellee the power

[2] "ITEM 11. The income and payments herein provided for my wife and children and the issue of my children are for their, and each of their, sole and separate use, maintenance and support, and are in no event to be liable for any debts contracted by them or any of them, and are not to be liable to attachment or assignment, but are solely and exclusively for their and each of their sole and individual use, maintenance and support, and none of the income and payments shall vest in the said cestuis que trustent, or either of them, until payments shall have been made to her or to him, as the case may be."

[3] Whether such limitations are valid has no bearing here as we are only interested in them as they reflect the decedent's intent.

[4] "ITEM 12. In the event of a serious illness or a financial emergency affecting my wife or any of my children, I herewith direct and authorize my Trustee to pay, in addition to other payments hereinbefore provided for, to my wife, or to my children, as the case may be, an amount not exceeding Fifteen Hundred Dollars ($1500.00), the said amount to be determined by my Trustee, as in its discretion the same may be necessary, during such illness or financial difficulty. The said payments to any child or children to be considered as an advancement and to be deducted, from the respective share of said child or children."

to authorize payments over and above the monthly stipend up to $1500 in the event of a serious illness or financial emergency affecting the surviving spouse. Whether the figure of $1500 is in the aggregate or may be paid in each event is unclear.

Decedent's adjusted gross estate was $199,749.96. Appellee sought to qualify the maximum amount, one-half of that adjusted gross estate, $99,874.98, as a marital deduction in accordance with Sections 2056(c)(1)[5] and 2056(b)(5)[6] of the 1954 Internal Revenue Code. The value of the property passing outside the will, to the decedent's spouse, $41,751.02, was combined on the estate tax return with the full value of the testamentary residuary trust, $69,245.85, to total $110,996.87. That portion of $110,996.87 which constituted one-half of the adjusted gross estate, $99,874.98, was listed, as noted above, as qualifying for the marital deduction. Appellant eliminated the full value of the testamentary residuary trust from the claimed marital deduction and thus decreased the amount of the allowable marital deduction to $41,751.02. The deficiency in estate tax was paid, a claim for refund was disallowed, appellee filed suit for refund, and after motions for summary judgment were presented by both parties, the District Court ruled in favor of the appellee and granted the refund.[7]

The District Court did not, as proposed by appellee, conclude that the entire value of the trust corpus, $69,245.85, could be considered for the marital deduction. Instead, it applied a Treasury Department actuarial formula to value the present worth of the surviving spouse's monthly stipend. This formula

[5] 26 U.S.C. § 2056(c)(1) (1965).

[6] 26 U.S.C. § 2056(b)(5) (1965).

[7] Northeastern Pennsylvania Nat. B. & T. Co. v. United States, 235 F. Supp. 941 (M.D.Pa. 1964).

produced a value of $63,663.43. This was added to $41,751.02, the value of the property passed to the surviving spouse outside the will, to total $105,414.45, an amount in excess of one-half of the decedent's adjusted gross estate, $99,874.98, the maximum allowable statutory marital deduction. The District Court thus concluded that appellee was entitled to the full marital deduction of $99,874.98, and judgment was entered for $17,574.45 plus interest, representing the tax found to have been unlawfully collected by appellant.

As the marital deduction provisions function today, under a trust arrangement such as the one involved herein, the entire corpus of the trust qualifies for inclusion in the estate tax return as part of the marital deduction if each of two prerequisites [8] are met: (1) the surviving spouse is entitled to all the income produced from the corpus for the remainder of the survivor's life with (2) power in the survivor to appoint the entire corpus remaining at the time of the power's exercise. If the survivor's requisite relationship to the corpus bars the qualification of the entire corpus for the deduction, a part of the trust corpus will qualify for marital deduction status if the survivor is entitled to the income from a "specific portion" of the whole, whether there be a power to appoint the entire interest remaining at the time of the power's exercise or the power to appoint only a part thereof.[9]

[8] There are other contingencies not relevant to the problem at hand.

[9] Consistent with this, only a part of the corpus will qualify for marital deduction status if the survivor is entitled to all the income from the corpus for life but may only appoint a "specific portion" of the remainder of the corpus at the time of the power's exercise. Similarly, only a part of the corpus, the smaller of the two specific portions, will qualify for marital deduction status if only a "specific portion" of the income may

Appellant's administrative regulation [10] has defined "specific portion" as a fractional or percentile part of the entire corpus. The practical effect of the marital deduction is to defer taxation of some part of the decedent's estate passing to the surviving spouse until the death of the surviving spouse.

Reviewing the purpose of the marital deduction, Mr. Justice Goldberg speaking for a unanimous court in *United States* v. *Stapf* [11] explained:

> "The 1948 tax amendments were intended to equalize the effect of the estate taxes in community property and common-law jurisdictions.[12] [Footnote omitted.] Under a community property system, such as that in Texas, the spouse receives outright ownership of one-half of the community property and only the other one-half is included in the decedent's estate. To equalize the incidence of progressively scaled estate taxes and to adhere to the patterns of state law, the marital deduction permits a deceased spouse, subject to certain requirements, to transfer free of taxes one-half of the non-community property to the surviving spouse. Although applicable to separately held property in a community property state, the primary thrust of this is to extend to taxpayers in common-law states the advantages of 'estate splitting' otherwise available only in community property States."

Problems that have arisen in this area have in the main concerned the extent to which the advantages of estate-splitting are to be allowed. Towards clarification of this issue, the above noted interpretive

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go to the survivor for life and if the survivor's power of appointment is limited to a "specific portion" of the remaining corpus at the time of the power's exercise. See 26 C.F.R. § 20.2056(b)-5(b) (1961).

[10] 26 C.F.R. § 20.2056(b)-5(b) (1961).

[11] 375 U.S. 118, 128 (text and n. 12) (1963).

regulation was promulgated. A detailed discussion of the congressional intent behind the passage of the 1948 Revenue Act appears in Senate Report No. 1013, March 16, 1948 [to accompany H.R. 4790]. In that Report, the marital deduction additions to the 1949 Code are characterized as follows:

> "These provisions have the effect of allowing a marital deduction with respect to the value of property transferred in trust or at the direction of the decedent *where the surviving spouse,* by reason of her right to the income and a power of appointment, *is the virtual owner of the property.*" [12]

And, as above detailed, the virtual ownership interest encompasses that existent in a "specific portion" of the trust corpus.

In sum, the propriety of granting a marital deduction in this case must be measured by the purpose of the marital deduction as expressed in *Stapf,* the interpretive regulation as promulgated by the Internal Revenue Service, the expression of the congressional intent on the subject, and the decedent's intent in structuring the existent trust arrangement.

II

As the survivor has been given in Paragraph 6 the right to appoint the entire corpus, no question arises in this case concerning the "specific portion" of the corpus to which the power extends. The contentions concern solely the relationship between the survivor's monthly stipend and the trust corpus—whether the decedent's trust arrangement placed in his surviving spouse the right to all the income from the corpus, or all the income from a "specific portion" thereof?

[12] 2 U.S. Code Cong. and Ad. News, 80th Cong., 2nd Session, p. 1238 (1948) (Emphasis added.)

The appellee has offered alternative arguments, as it did before the District Court, to justify either the inclusion of the entire $69,245.85 residuary trust in the estate tax return as appropriate for marital deduction status or the inclusion of $63,663.43 in the return as a "specific portion" of the residuary trust thus qualifying for marital deduction status.

The District Court rejected, properly we believe, appellee's contention that the entirety of the trust corpus of $69,245.85 be entitled to marital deduction status. It was pointed out that appellee's position fails for, in deciding whether the survivor is entitled to receive all the income from the trust corpus for life, the determinative factor is what income the trust corpus *could* produce and not what is *now* being produced, or what ultimately *will* be produced. Here, the corpus may be able to produce more than the survivor's monthly stipend. The surplus would have to be accumulated and the survivor would have no right to the *present enjoyment* of the excess income, even though, as argued by appellee, she would have the power to appoint it. Thus, the survivor would not be entitled to the entire income which might come from the corpus, within the intendment of Section 2056(b)(5) of the 1954 Internal Revenue Act.[13] This very real consideration must also be given appropriate weight in determining whether the survivor is entitled to the

[13] It should be noted in passing that it would be unrealistic to conceive of an unlimited income potential from a trust whose trustees, by law, must stay within the bounds of certain guidelines. Such a consideration may play a part in another case at another time. Here, however, appellee does not argue, nor does the record reflect, that the appellee, by law, cannot invest the corpus to proudce an income in excess of the monthly stipend. Thus the potentiality of the production of an income in excess of the monthly stipend to the survivor is a real factor which has been, and must be, given its due weight by the courts.

income from a "specific portion" of the trust, and what such "specific portion" is.

Was appellee, as found by the District Court, entitled to the inclusion in its tax return of $63,663.43 from the corpus as a "specific portion" thereof—a part in which the surviving spouse had a total income interest? The method of actuarial computation used by the District Court, along with the efficacy of the use of any actuarial method of computing "specific portion", is of primary concern and requires analysis. It is well to underline the statutory language which must be considered in this respect. Section 2056 (b)(5) of the Code makes it clear that "specific portion" is that part of the trust corpus from which the surviving spouse is entitled to "all the income." Thus, unless the actuarial formula used by the District Court succeeds in isolating that part of the trust corpus from which the survivor is entitled to *all* the income for her lifetime, the computation is of no value. The actuarial method on which this case has been turned does not, in our view, isolate that part of the trust corpus from which the surviving spouse is entitled to all the income.

The District Court, in computing the present worth of the survivor's monthly stipend, applied a formula used by the Treasury Department in the "valuation of annuities, life estates, terms for years, remainders and reversions." This may be found in 26 C.F.R. § 20.2031-7 (1961). The formula valued the worth of the monthly stipends by multiplying together the following factors: $300 (amount of monthly payment); 12 (number of months in a year); 1.0159 (factor for monthly payments); and 17.3911 (factor for the discount rate of 3½ percent over the period of the widow's life expectancy). The present worth of the $300 monthly stipend was determined to be $63,663.43,

a "specific portion" of the trust corpus, and thus qualifying for marital deduction status. The District Court thus rejected the Treasury Regulation noted above so far as it required the "specific portion" to be specified in fractional or percentile form.

As an initial matter, we find the formula inappropriate in determining what part of a trust corpus may be considered a "specific portion" for marital deduction purposes. First, the mere fact that the formula is one for valuing an annuity eliminates it as appropriate for determining "specific portion." The factor 17.3911 in the formula represents the present worth of one dollar invested in an annuity at 3½ percent over the remaining life expectancy of a person forty-two years of age, the age of the surviving spouse at the decedent's death. The formula thus provides a discount value through a process of capitalizing at 3½ percent what are directed to be $300 monthly payments. If $63,663.43 is invested at age forty-two, that amount will provide the annuitant the required monthly payments for her entire life. At death the entire fund will have been dissipated. However, the factor of fund dissolution has in no way been contemplated by the decedent. The formula thus intrudes an artificial element into our problem, an element inconsistent with what the District Court in effect conceded to be the income production potential of the corpus when it ruled that appellee was not entitled to a marital deduction for the full value of the trust corpus.

Second, the monthly stipend alloted under the trust arrangement, $300 initially, is placed into the formula as the amount of *income* which a given fund must produce. However, under the trust arrangement, the trustees have not been directed to invest the corpus so that it will yield a given monthly income. All that

has been directed is that the survivor receive such income, *even if corpus must be invaded* to make up the difference between the income yield of the corpus per month and the stipend allotment. And if the income yield be greater than $300 in a given month, the excess is to be accumulated. Thus, inclusion of the $300 figure in the formula is inappropriate for it equates the monthly stipend with the income yield from the corpus, elements which are in no way interchangeable.

Third, and this has a direct bearing on the point just made, the formula may be characterized as one which attempts to capitalize a given monthly stipend and produce a capital value, $63,663.43, which is to be the "specific portion" for marital deduction purposes. Such a method of computation is improper for we already know what is the value of the entire trust. Only from that given value of $69,245.85 may any computation of "specific portion", if any be appropriate, proceed. Under the formula used by the District Court, the results that may be reached demonstrate the inappropriateness of a capitalization method which disregards the present value of the trust corpus. Assume for a moment a direction that appellee pay $350 monthy as a stipend to the surviving spouse as of the date of decedent's death. Capitalizing a $350 monthly stipend under the District Court's formula for determining "specific portion", the capital value figure reached is $74,199.80, a sum in excess of the value of the entire trust corpus. As stated above it is conceded that the estate is not entitled to a marital deduction for the sum of the entire trust corpus, because of the potentialities of income production. Yet, under the actuarial formula used to determine "specific portion", the formula accepted by the District Court, at least the entire value of

the corpus is to qualify for the deduction as a "specific portion" of the entirety, and theoretically a sum in excess of the entire trust corpus's value will qualify. The incongruity of equating the monthly stipend with the income yield is manifest.

Finally, in determining the "specific portion" of a given trust corpus from which part the survivor has an absolute income right, actuarial computation is inappropriate when the formula uses variable factors other than mere life expectancy. The use of the monthly stipend as the income factor in the formula noted above exemplifies the attempt to make constant that which is variable in this case. The 3½ percent investment factor in the actuarial formula is likewise unreal. As previously indicated, Congress's intent was to give a marital deduction to those interests of a surviving spouse in a common law jurisdiction which were akin to the fee simple interest held by a survivor in a community property state. Such an interest, to qualify as akin to a fee simple interest, must be subject to the rise and fall of the market. An investment constant, such as 3½ percent in the instant case, though accepted in actuarial formulas, has no place in a problem where the very real income variations turn the issue of the allowance of the marital deduction. Indeed, the use of such a constant is absent from the regulations dealing with the "specific portion" issue, whereas it may be found in the regulations in formulas geared to different problems.

Having attempted to demonstrate the inappropriateness of the formula used by the District Court, the question arises as to whether, under the facts of this case, there does exist a method for isolating a "specific portion" of the trust corpus to qualify for marital deduction status? The term "specific portion" has been appropriately defined in this manner:

> "Presumably, specific portion does not mean anything more than a designation of the amount of the surviving spouse's interest *which makes it feasible to compute the amount of the marital deduction.*" [14]

Feasible computation of a "specific portion" is the key to marital deduction status.

The Internal Revenue Service in its above noted regulation considers any testamentary trust which describes the relationship between the income to be received by the survivor and the trust corpus in anything but "fractional or percentile" terms as one which expresses a relationship falling outside the susceptibility of computation, and thus one which thwarts a determination of "specific portion" for purposes of the marital deduction. *Gelb* v. *C.I.R.*, [15] heavily relied upon by appellee and the District Court, expressed a view which is contrary to the interpretive regulation. In *Gelb* the surviving spouse was entitled to *all* the income from the trust corpus for her life. As distinguished from the case at hand, the issue in *Gelb* was whether the survivor had a power of appointment over a "specific portion" of the trust corpus. That problem arose because the trustees in *Gelb* were empowered to invade the corpus, in their discretion, to the extent of $5,000 per year for the support, education and maintenance of the decedent's minor daughter. The Government argued that the relationship between the extent of the invasion of corpus for purposes of supporting, educating, and maintaining the decedent's minor child, and the entirety of the corpus, was not expressed in "fractional or percentile" form and thus there was no "specific portion" for marital

[14] Lowndes and Kramer, Federal Estate and Gift Taxes 407 (1956). (Emphasis added.)

[15] 298 F.2d 544, 551 (2 Cir. 1962).

deduction purposes. The Second Circuit reviewed the use of actuarial formulas at some length and then finding for the taxpayer, remanded the case to the Tax Court to determine how much of the trust corpus qualified for the marital deduction under the actuarial principles which had been discussed. Though there was no mention of what particular formula should be applied, in either the Second Circuit's opinion or the stipulation of dismissal by the parties on the remand indicating the lump sum of the taxpayer's overpayment,[16] *Gelb* can easily be read to be consistent with the result for which the appellant contends in the instant case. Under the facts of *Gelb* only the life expectancies were subject to variation. By applying the $5,000 figure, the *maximum* extent to which the trustees could invade the trust corpus annually, together with the combined average figure of the surviving spouse's and minor child's life expectancies, the lump sum amount to be carved out of the trust corpus could be acceptably *maximized* by the computation. The remainder would be that part of the trust corpus, the "specific portion", to which the estate would be entitled to a marital deduction, a part of the corpus which in no reasonable event could be invaded for interests other than those of the surviving spouse.

The *Gelb* principles and disapproval of the Government's regulation are appropriate to the facts of *that* case. But there is no need to take a position concerning the validity of that interpretive regulation, as it applies to this case. Suffice it to say, even assuming its invalidity, we have been unable to conceive of a method to compute the "specific portion" of the trust corpus to which the surviving spouse is entitled to all the income for her life. There are too many variables

[16] See U.S. Tax Ct. Docket No. 71095, stipulation entered July 26, 1962.

here. The market conditions for purposes of investment are unknown. If they are poor, a greater invasion of corpus to meet the monthly stipend will be necessary, causing a concomitant diminution of income. If market conditions are good corpus may not have to be invaded, and income accumulations may indeed accrue. Furthermore, the extent to which the appellee may, under Paragraph 12 of the will, choose to invade corpus for illness and financial emergencies is an unknown factor of considerable moment in any computation of "specific portion". Thus, in this case, the factual constants do not exist upon which the maximum income can be theoretically computed, as it was possible to theoretically compute the maximum invasion of corpus in *Gelb*. In short, the ratio between the maximum monthly income and the monthly stipend—the fraction of the entire corpus which would be the "specific portion" for marital deduction purposes—may not be acceptably computed."[17]

[17] An illustration of an acceptable computation, given factual constants such as inhere in *Gelb*, is the following: If the investment factors involved were constant and it could be determined that the *maximum* income that could be produced from the corpus in a month was, for example, $500, then the relationship between the $300 monthly stipend and the $500 maximum income would define "specific portion" for marital deduction purposes, *i.e.*:

> $300 being 3/5 of $500 then 3/5 of $69,245.85 would be the "specific portion" of the trust corpus from which the surviving spouse would be entitled to the entire income of $300 monthly *under maximum production circumstances.*

Though in reality it might take the entire corpus to produce the monthly stipend, or even the necessity to invade corpus might be present, nevertheless, in line with *Gelb*, it could be said, after computing the theoretical maximum income, that the surviving spouse's income interest of $300 monthly represented the investment of 3/5 of the corpus. "Specific portion" would then be accurately defined for marital deduction purposes. Let

In essence then, neither the District Court's formula, nor any other method of calculation of which we can conceive, when applied to the facts of this case, provides a method to handle the problem of maximizing the investment potential of the trust corpus. Because the marital deduction is to be allowed only when the trust beneficiary has been given an interest akin to a fee simple, what *might* ultimately happen to the invested corpus is the central consideration in determining marital deduction qualification, and the ability to maximize future investment potential is crucial to qualification, absent a fractional or percentile expression of the right to income from the trust corpus. Thus, even if done with precision, the time of the decedent's death is the inappropriate time at which to freeze the income production status of the invested corpus for purposes of qualifying a "specific portion" for the marital deduction.

We have reached the above conclusion with an awareness that a three-judge panel of the Seventh Circuit has most recently expressed contrary views, one judge dissenting.[18] We think the observation of the dissenter, however, in characterizing the impact of the formula used in that case—"something judicially rationalized as approximately equivalent is not enough" [19]—is most appropriate. In our view, therefore, appellant's position is sustained.[20]

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it be re-emphasized, however, that the necessary constants are absent in the instant case upon which a computation may be based.

[18] *Citizens Nat'l Bank of Evansville, Exr.* v. *U.S.*, 2 Fed. Est. & Gift Tax Rep. § 12,394 at 8167–71 (April 11, 1966).

[19] *Id.* at 8171.

[20] For a like result under somewhat different facts see *Flesher* v. *United States*, 238 F. Supp. 119, 124 (N.D.W.Va. 1965). See 4 Mertens, Law of Federal Gift & Estate Taxation 145 (July 1965 Monthly Supp.).

Sustaining the appellant's position is consistent with both the decedent's intent as expressed in his will and the purpose behind the marital deduction provision. The decedent's intent emerges rather clearly from Paragraph 11 of his will. In reciting that the monthly stipends were to be used exclusively for the survivor's sole and individual use, maintenance, and support, sums which he endeavored to make neither liable for any debts contracted by her, nor subject to her assignment, the decedent evidenced a desire to limit the survivor's control over the monthly stipend. By also limiting the amount of these stipends to a sum which could fall below the income production of the corpus, the decedent evidenced an intent to give to his surviving spouse only that which he thought would be proper for her support and maintenance. Such an interest falls short of expressing a desire to place in the hands of his survivor an interest akin to a fee simple, the only interest which Congress viewed as meeting the standards of marital deduction status.

The judgment of the United States District Court for the Middle District of Pennsylvania will be reversed and the case remanded for entry of summary judgment in favor of appellant.

By GANEY, *Circuit Judge, dissenting.*

Clarence C. Young died on May 3, 1958. Surviving him were his widow, who was 42 years old at the time, and four children, whose ages are not disclosed by the record. He left a last will and testament in which the plaintiff was named executor and trustee of the estate. Item 6 thereof provided as follows:

> "ITEM 6. I give, devise and bequeath one-half (½) of all the rest, residue and remainder of my estate, whatsoever and wheresoever the same may be, both real and personal, to which

I may be entitled, or which I may have power to dispose of at the time of my death, unto my Trustee, hereinafter named and designated, to have and to hold the same in trust, nevertheless, as hereinafter provided.

"(a) I direct my Trustee to pay out of the said income and corpus of the said estate unto my wife, Beatrice O. Young, the sum of Three Hundred Dollars ($300.00) per month for and during the period until my youngest child reaches the age of eighteen years and thereafter I direct my Trustee to pay to my wife, Beatrice O. Young, the sum of Three Hundred Fifty Dollars ($350.00) per month for and during the rest of her natural life.

"(b) If my wife survives me, she shall have the power, exercisable by Will, to appoint to her estate or to others, any or all of the principal remaining at the time of her death. If my wife fails to appoint the entire principal to her estate or to others as above mentioned, then upon her death (or if she predeceases me, then upon my death) any principal remaining at that time shall be paid over to my children on the same terms and conditions as under Item 7 of this my Will."

It is to be noted that the surviving widow is to have the income from all of the trust estate, as well as the power of appointment over the same by her last will and testament as to all or any part thereof. At the time of the decedent's death, the value of the testamentary residuary trust passing under the will, to which all parties were in agreement, was $69,245.85. The widow also received outright from the decedent's estate at the time of his death, property and money valued at $41,751.02. One-half of the decedent's adjusted gross estate amounted to $99,874.98 and the executor of the estate reported this value as a marital deduction in the Federal estate tax return and took therein as a partial deduction the $41,751.02.

Section 2056(b)(5) of the Internal Revenue Code of 1954, 26 U.S.C. § 2056,[21] remedied previous legislation which failed to provide for a situation in which the surviving spouse received an interest less than all of the trust income or the power to appoint less than all of the trust property, to the extent that, where the surviving spouse is entitled for life to all of the income from a "specific portion" thereof with power in the surviving spouse to appoint such "specific portion", it will qualify for the marital deduction. The phrase "specific portion" is nowhere defined in the statute, but Treasury Regulations on Estate Tax (1954 Code), Sec. 20.2056(b)-5[22] so does, and therein it provides

[21] This section reads as follows:

"(5) *Life estate with power of appointment in surviving spouse.*—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, *or all the income from a specific portion* thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse. * * *" [Emphasis supplied.]

[22] This section, in pertinent part, reads as follows:

"Marital Deduction; Life Estate with Power of Appointment in Surviving Spouse.

"(c) *Definition of 'specific portion'.* A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to one-half or a specified percentage of the property, or the equivalent, the interest

as set forth below that the surviving spouse's right to income must be a fractional or percentile share of the trust corpus.

The Commissioner of Internal Revenue disallowed any part of the $69,245.85, the value of the trust corpus to be included in the marital deduction and allowed only the $41,751.02, and assessed a deficiency estate tax of $14,966.23 plus interest at $2,608.22 against the estate. The executor paid the deficiency tax plus interest and brought this action in the United States District Court for the Middle District of Pennsylvania to recover those amounts. Both parties moved for summary judgment and the court below decided in favor of the executor in 235 F. Supp. 941, and the United States has prosecuted this appeal.

It is the Government's contention here that (1) since the surviving spouse is not entitled to all the income from the entire corpus during her lifetime, because under the terms of the decedent's will income from the trust could have exceeded $300.00 per month and the surplus would then have to be accumulated and therefore the trust becomes disqualified.[23] Fur-

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is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest. Even though the rights in the surviving spouse may not be expressed in terms of a definite fraction or percentage, a deduction may be allowable if it is shown that the effect of local law is to give the spouse rights which are identical to those she would have acquired if the size of the share had been expressed in terms of a definite fraction or percentage * * *."

[23] See S. Rep. No. 1013, Part 2, 80th Cong., 2d Sess., p. 17 (1948–1 Cum. Bull. 285, 342–343), U.S. Code Cong. Service 1948, p. 1239: "(3) The surviving spouse must be entitled to the income from the corpus of the trust annually, or at more frequent intervals. This requirement disqualifies any trust the income of which is required to be accumulated or may, in the discretion of the trustee, be accumulated."

thermore, (2) the $300.00 per month allotted as income to the widow is not in conformity with the Treasury Regulation cited above since it is not fractional or percentile and no part of it, accordingly, could qualify for the marital deduction. The court below is in agreement with the first portion of the Government's contention that the plaintiff is not entitled to take as a marital deduction the value of the property passing to the spouse under the testamentary residuary trust. However, on the other hand, the contention of the executor is that since the trust makes provision for setting up a monthly income to the surviving spouse, and she alone, under the will, was granted all of the income from the trust corpus, as well as being given power to dispose of all of her interest by appointment, the plaintiff was entitled to take as a marital deduction the value of the $300.00 per month as a "specific portion" as may be computed actuarily. Since the surviving spouse is absolutely entitled to, presently, $300.00 per month, and if this amount is construed to represent income from corpus, then the amount of the corpus which would yield this income could be ascertained and regarded as qualifying as a "specific portion" for the marital deduction. Here, the court rejects the Government's second contention and agrees with the above contention of the executor since the underlying purpose of Congress in enacting the marital deduction provision of the statute was that it might conform to the pattern of state law in those states which permit transfer free of taxes of one-half of the known community property to the surviving spouse in what has been referred to as community property states. It is, accordingly, our duty to construe the statute as liberally as we can in order to effectuate such policy.

The value of this right was computed by multiplying together the following factors: $300.00 (amount of monthly payment); 12 (number of months in a year); 1.0159 (factor for monthly payments) and 17.3911 (factor for the discount rate of 3½% over the period of the widow's life expectancy). See Sec. 20.2031–7 of the Treasury Regulations of the Estate Tax provisions of the 1954 Internal Revenue Code, 26 C.F.R. Part 20–29 (Rev'd. 1961) Sec. 20.2031–7. *Citizens National Bank of Evansville* v. *United States,* (S.D. Ind. 1965), 65–1 USTC ¶ 12,302, a similar case was decided in this way. This right had a value, according to this actuarial computation, of $63,663.43. The executors contend that this was a "specific portion" of the trust corpus and that the Treasury Regulation so far as it required a fractional or percentile part of the trust was invalid as being the only and exclusive indication of Congressional intent.

With this contention of the executor, I likewise agree. While, as I have indicated, all of the value of $69,245.85 could not be taken as a marital deduction, certainly $300.00 monthly for life devised in trust for his wife had a value at the time of his death and this value could be related to, or be a specific portion of, the entire corpus, and, as determined, it amounted to $63,663.43. This figure is reached after a reasonable calculation of the present worth of $300.00 over the life expectancy of the wife. I do not take into consideration fluctuation, wide or narrow, of the value of the corpus or the income thereon, over what would be the life expectancy of the wife, since the marital deduction is taken only once, at the death of testator, and I determine then what could be its value and not what might ultimately happen. "We cannot wait, like Monday morning quarterbacks, to see what actually happened, but must concern ourselves with what could

have happened." *Bookwalter* v. *Lamar*, 232 F. 2d 664, 670.

It is in conformity with this that I do not take into consideration the $350.00 stipend somewhat later to be paid to the beneficiary, as it is prospective of an exigency which might never occur, and, as has been indicated, I take the marital deduction but once and at the date of the testator's death and hence the amount of the stipend at that time. This construction does not strain the statutory intent nor does it, in any wise, work a change in the phrase, "specific portion", and is fully in accord with the mandate of the statute that anyone seeking the marital deduction must satisfy the requirements thereof, which is the requisite rule in statutory construction. *United States* v. *Olympic Radio & Television*, 349 U.S. 232, 235; *Deputy* v. *Dupont*, 208 U.S. 488, 493; *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440.

The final point of the majority here is an attempt to extract, from paragraph 11 of the testator's will, an intent by him to "limit the survivors' control over the monthly stipend", thus not making it akin to a fee simple.

Paragraph 11 merely provides that the fund created for the wife is for her "sole and separate use, maintenance and support" and not "only that which he thought would be proper for her support and maintenance", as stated by the majority.

As a matter of fact, this paragraph of the will has no real bearing on the issue here presented, for if the testator had provided a percentile interest for the wife, instead of a monthly stipend, this paragraph would have been equally applicable to it, so even if expressed in a percentile interest, the majority, taking the position they do here, would thus be defeating their own argument.

Since the wife gets all of the income from the specific portion and has the power of appointment over all of it, this method of determining the specific portion of the corpus by evaluating the life interest at the time of the testator's death is, in my judgment, neither inconsistent nor irreconcilable with the statutory requirement.

Furthermore, while this formula may not be a perfect one, its components are fair and reasonable and tested by Governmental experience and, therefore, it seems but just that some value be given the stipend at the testator's death in order to qualify for the marital deduction, in conformance with the desire of Congress to give full effect to its marital deduction in order that it might level off any inequality resulting from community property states, rather than let the field lie fallow and adopt a sterile attitude of defeatism because the testator has not resorted to fractional or percentile figures.

The value of the "specific portion" being ascertained at $63,663.43 within the intendment of the statute, plus the $41,757.02 already taken as a deduction, therefore exceeds the allowable marital deduction of $99,874.02, and therefore $58,117.00 of the $63,663.43, the value of the "specific portion", should be allowed additionally.

Accordingly, I would affirm the judgment of the lower court.

Chief Judge Staley and Judge McLaughlin join in this dissent.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

APPENDIX C

Internal Revenue Code of 1954:

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) *Allowance of Marital Deduction*—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c) and (d) be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(b) *Limitation in the Case of Life Estate or Other Terminable Interest.*—

(1) *General rule.*—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

(A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse; and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))—

(C) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this paragraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

* * * * *

(5) *Life estate with power of appointment in surviving spouse.*—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the

entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

* * * * * *

(c) *Limitation on Aggregate of Deductions.*—

(1) *General rule.*—The aggregate amount of the deductions allowed under this section (computed without regard to this subsection) shall not exceed 50 percent of the value of the adjusted gross estate, as defined in paragraph (2).

(2) *Computation of adjusted gross estate.*—

(A) *General rule.*—Except as provided in subparagraph (B) of this paragraph, the adjusted gross estate shall, for purposes of subsection (c)(1), be computed by subtracting from the entire value of the gross estate the aggregate amount of the deductions allowed by sections 2053 and 2054.

(B) *Special rule in cases involving community property.*—If the decedent and his surviving spouse at any time, held property as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, then the adjusted gross estate shall, for purposes of subsection (c)(1), be determined by subtracting from the entire value of the gross estate the sum of—

(i) the value of property which is at the time of the death of the decedent held as such community property;

* * * * * *

[26 U.S.C. (1958 ed.) Sec. 2056.]

Treasury Regulation on Estate Tax (1954 Code):

Sec. 20.2056(b)–5 MARITAL DEDUCTION; LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.

(a) *In general.* Section 2056(b)(5) provides that if an interest in property passes from the decedent to his surviving spouse (whether or not in trust) and the spouse is entitled for life to all the income from the entire interest or all the income from a specific portion of the entire interest, with a power in her to appoint the entire interest or the specific portion, the interest which passes to her is a deductible interest, to the extent that it satisfies all five of the conditions set forth below (see paragraph (b) of this section if one or more of the conditions is satisfied as to only a portion of the interest):

(1) The surviving spouse be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest.

(2) The income payable to the surviving spouse must be payable annually or at more frequent intervals.

(3) The surviving spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate.

(4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the surviving spouse.

(b) *Specific portion; deductible amount.* If either the right to income or the power of appointment passing to the surviving spouse pertains only to a specific portion of a property interest passing from the decedent, the marital de-

duction is allowed only to the extent that the rights in the surviving spouse meet all of the five conditions described in paragraph (a) of this section. While the rights over the income and the power must coexist as to the same interest in property, it is not necessary that the rights over the income or the power as to such interest be in the same proportion. However, if the rights over income meeting the required conditions set forth in paragraph (a) (1) and (2) of this section extend over a smaller share of the property interest than the share with respect to which the power of appointment requirements set forth in paragraph (a) (3) through (5) of this section are satisfied, the deductible interest is limited to the smaller share. Correspondingly, if a power of appointment meeting all the requirements extends to a smaller portion of the property interest than the portion over which the income rights pertain, the deductible interest cannot exceed the value of the portion to which such power of appointment applies. Thus, if the decedent leaves to his surviving spouse the right to receive annually all of the income from a particular property interest and a power of appointment meeting the specifications prescribed in paragraph (a) (3) through (5) of this section as to only one-half of the property interest, then only one-half of the property interest is treated as a deductible interest. Correspondingly, if the income interest of the spouse satisfying the requirements extends to only one-fourth of the property interest and a testamentary power of appointment satisfying the requirements extends to all of the property interest, then only one-fourth of the interest in the spouse qualifies as a deductible interest. Further, if the surviving spouse has no right to income from a specific portion of a property interest but a testamentary power of appointment which meets the necessary conditions over the entire interest, then none of the

interest qualifies for the deduction. In addition, if, from the time of the decedent's death, the surviving spouse has a power of appointment meeting all of the required conditions over three-fourths of the entire property interest and the prescribed income rights over the entire interest, but with a power in another person to appoint one-half of the entire interest, the value of the interest in the surviving spouse over only one-half of the property interest will qualify as a deductible interest.

(c) *Definition of "specific portion".* A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to one-half or a specified percentage of the property, or the equivalent, the interest is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest. Even though the rights in the surviving spouse may not be expressed in terms of a definite fraction or percentage, a deduction may be allowable if it is shown that the effect of local law is to give the spouse rights which are identical to those she would have acquired if the size of the share had been expressed in terms of a definite fraction or percentage. The following examples illustrate the application of this and the preceding paragraphs of this section:

Example (1). The decedent transferred to a trustee 500 identical shares of X Company stock. He provided that during the lifetime

of the surviving spouse the trustee should pay her annually one-half of the trust income or $6,000, which ever is the larger. The spouse was also given a general power of appointment, exercisable by her last will over the sum of $160,000 or over three-fourths of the trust corpus, whichever should be of larger value. Since there is no certainty that the trust income will not vary from year to year, for purposes of paragraphs (a) and (b) of this section, an annual payment of a specified sum, such as the $6,000 provided for in this case, is not considered as representing the income from a definite fraction or a specific portion of the entire interest if that were the extent of the spouse's interest. However, since the spouse is to receive annually at least one-half of the trust income, she will, for purposes of paragraphs (a) and (b) of this section, be considered as receiving all of the income from one-half of the entire interest in the stock. Inasmuch as there is no certainty that the value of the stock will be the same on the date of the surviving spouse's death as it was on the date of decedent's death, for purposes of paragraphs (a) and (b) of this section, a specified sum, such as the $160,000 provided for in this case, is not considered to be a definite fraction of the entire interest. However, since the surviving spouse has a general power of appointment over at least three-fourths of the trust corpus, she is considered as having a general power of appointment over three-fourths of the entire interest in the stock.

* * * * *

(d) *Definition of "entire interest"*. Since a marital deduction is allowed for each qualifying separate interest in property passing from the decedent to his surviving spouse (subject to the percentage limitation contained in §§ 20.2056 (c)–1 and 20.2056 (c)–2 concerning the aggregate amount of the deductions), for purposes

of paragraphs (a) and (b) of this section, each property interest with respect to which the surviving spouse received some rights is considered separately in determining whether her rights extend to the entire interest or to a specific portion of the entire interest. A property interest which consists of several identical units of property (such as a block of 250 shares of stock, whether the ownership is evidenced by one or several certificates) is considered one property interest, unless certain of the units are to be segregated and accorded different treatment in which case each segregated group of items is considered a separate property interest. The bequest of a specified sum of money constitutes the bequest of a separate property interest if immediately following distribution by the executor and thenceforth it, and the investments made with it, must be so segregated or accounted for as to permit its identification as a separate item of property. The application of this paragraph may be illustrated by the following examples:

Example (1). The decedent transferred to a trustee three adjoining farms, Blackacre, Whiteacre, and Greenacre. His will provided that during the lifetime of the surviving spouse the trustee should pay her all of the income from the trust. Upon her death, all of Blackacre, a one-half interest in Whiteacre, and a one-third interest in Greenacre were to be distributed to the person or persons appointed by her in her will. The surviving spouse is considered as being entitled to all of the income from the entire interest in Blackacre, all of the income from the entire interest in Whiteacre, and all of the income from the entire interest in Greenacre. She also is considered as having a power of appointment over the entire interest in Blackacre, over one-half of the entire interest in Whiteacre, and over one-third of the entire interest in Greenacre.

Example (*2*). The decedent bequeathed $250,000 to C, as trustee. C is to invest the money and pay all of the income from the investments to W, the decedent's surviving spouse, annually. W was given a general power, exercisable by will, to appoint one-half of the corpus of the trust. Here, immediately following distribution by the executor, the $250,000 will be sufficiently segregated to permit its identification as a separate item, and the $250,000 will constitute an entire property interest. Therefore, W has a right to income and a power of appointment such that one-half of the entire interest is a deductible interest.

Example (*3*). The decedent bequeathed 100 shares of Z Corporation stock to D, as trustee. W, the decedent's surviving spouse, is to receive all of the income of the trust annually and is given a general power, exercisable by will, to appoint out of the trust corpus the sum of $25,000. In this case the $25,000 is not, immediately following distribution, sufficiently segregated to permit its identification as a separate item of property in which the surviving spouse has the entire interest. Therefore, the $25,000 does not constitute the entire interest in a property for the purpose of paragraphs (a) and (b) of this section.

* * * * *

(f) *Right to income.* * * * (7) An interest passing in trust fails to satisfy the condition set forth in paragraph (a)(1) of this section, that the spouse be entitled to all the income, to the extent that the income is required to be accumulated in whole or in part or may be accumulated in the discretion of any person other than the surviving spouse * * *.

* * * * *

[26 C.F.R. Sec. 20.2056(b)–5.]

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966.

No. 488

UNITED STATES OF AMERICA,
Petitioner,

vs.

THE CITIZENS NATIONAL BANK OF EVANSVILLE,
AS EXECUTOR,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

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THE GUNTHORP-WARREN PRINTING COMPANY, CHICAGO

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OPINIONS BELOW.

The Findings of Fact and Conclusions of Law of the District Court are not officially reported. The opinion of the Court of Appeals is reported at 359 F. 2d 817.

JURISDICTION.

The jurisdictional requisites are adequately set forth in the Petition.

QUESTION PRESENTED.

Whether a bequest by a decedent to his surviving spouse of a specific monthly amount for life ($200.00 per month) from the corpus of a testamentary trust constituted, for the purpose of the marital deduction under the Federal Estate tax, bequest of "all the income from a specific portion" of the trust, within the meaning of Section 2056(b)(5) of the Internal Revenue Code of 1954.

STATUTE AND REGULATION INVOLVED.

The pertinent provisions of the statute and regulations involved, Sections 2056(a), (b)(1), (b)(5) and (c), of the Internal Revenue Code of 1954 and portions of Treasury Regulations (1954) Sections 20.2056(b)-5(a), (b), (c), (d) and (f), are set forth in the Petition in Appendix C.

STATEMENT.

G. Ashburn Koch died testate on September 25, 1959, survived by his widow, Mary Jane Koch, who was the sole beneficiary under his residuary trust created by his will which provided, in part, as follows:

> "In the event I die prior to October 1, 1961, I direct my Trustee to pay to my wife the sum of Two Hundred Dollars ($200.00) per month up to and through December 1, 1964, and then to pay to my wife the sum of Three Hundred Dollars ($300.00) per month after December 1, 1964, each and every month for the duration of her life. * * * Provided, however, anything hereinbefore set out notwithstanding, I order and direct that my wife, Mary Jane Koch, shall never receive less than the income produced from the corpus of my trust estate on and after December 1, 1964."

The Trustee was directed by the will to invest the trust estate so as to produce an income of at least four per cent

(4%) per annum and the decedent gave his wife a general testamentary power of appointment over the entire trust corpus. The value of the residuary trust estate was some One Hundred Twenty-Three Thousand Five Hundred Dollars ($123,500.00) and the sole issue is whether the right in decedent's widow to receive from his testamentary trust the sum of Two Hundred Dollars ($200.00) per month for life, with the power to appoint all the remainder of the trust, qualified for the marital deduction as a "specific portion" of the trust within the meaning of Section 2056 (b)-5 of the Internal Revenue Code of 1954. In all other respects, the trust qualified for the marital deduction without question. The surviving widow was the sole beneficiary of the trust created by the decedent and is the only person entitled to any trust income and was given the power of appointment over the entire principal remaining at her death. She was also given all of the income of the trust after December 1, 1964. It is only the fact that her income from the trust prior to December 1, 1964, was limited to a specific sum of Two Hundred Dollars ($200.00) per month that a question arises concerning the qualification of the trust, or apart thereof, for the marital deduction.

The basic principle underlying the marital deduction is that the spouse first to die shall be permitted to pass on to the surviving spouse, free of estate tax, up to one-half of his or her estate, provided only that the terms of the transfer are such that this property will be taxable in the estate of the surviving spouse. Section 2056(b)-5, of the Internal Revenue Code of 1954, allows the marital deduction to apply when the surviving spouse has the income for life from a "specific portion" of the trust with the power to appoint the remainder of the trust. A fixed income per month to a surviving spouse qualifies as the income from a "specific portion," inasmuch as such

"specific portion" can be mathematically computed and the regulations of the Internal Revenue Code recognize such computation for income tax, gift tax and estate tax purposes. The regulations of the Internal Revenue Code attempting to restrict the definition of "specific portion" to a portion or percentile share are not fairly within the statutory meaning and are unreasonable and do not express the congressional intent. The purpose of the marital deduction was to extend to married taxpayers in common-law states the advantages of residents of community property jurisdictions by permitting a surviving spouse to acquire free from Federal Estate taxation up to one-half of what is referred to as "the adjusted gross estate" of the deceased spouse.

This case falls squarely within the legislative intent and the trust set up by decedent is a practical expression of a gift of income couched in monthly payments. Inasmuch as the widow has the power to appoint the entire corpus of the trust and is entitled to Two Hundred Dollars ($200.00) a month for life plus all of the income after December 1, 1964, the only question is to calculate and set aside for marital deduction purposes that portion of decedent's trust which will produce Two Hundred Dollars ($200.00) a month. This the District Court below and the Seventh Circuit Court of Appeals below have adequately and correctly done.

I.

There Is No Conflict of Decision.

The Government asserts that there is a conflict of decisions between this case and the case of *Northeastern Pennsylvania National Bank & Trust Co.* v. *United States.* (Petitioner's Brief, App. B.) On the surface it might appear that there is a similarity between the fact situations, inasmuch as in the *Koch* case the decedent's widow was be-

queathed Two Hundred Dollars ($200.00) per month until December 1, 1964, and thereafter all the income from the trust and in the *Northeastern* case the widow was bequeathed Three Hundred Dollars ($300.00) per month, as a flat sum for life. However, there the similarity ends and the cases are easily distinguishable as follows:

A. In the *Koch* case, the value of the residuary trust was some $123,500.00, which is sufficient to produce a monthly income of Two Hundred Dollars ($200.00) per month even at two per cent (2%) return. Therefore, that specific portion of the trust estate, that is, $68,572.00 at three and one-half per cent (3½%) return (the percentile figure recognized by the Internal Revenue Service) will produce Two Hundred Dollars ($200.00) a month without the invasion of any of the corpus and the corpus of the trust would remain intact, to fluctuate with the rise and fall of the market and to be taxable in the estate of the widow at her death.

In the *Northeastern* case, the value of the trust was insufficient to produce income of Three Hundred Dollars ($300.00) a month and the method of determining the specific portion was a formula that amounted to capitalizing at three and one-half per cent (3½%) the sum of Three Hundred Dollars ($300.00) per month in monthly payments during the life expectancy of the widow (actuarily calculated) in the form of an annuity, so that the entire trust fund would have been dissipated and paid to the widow by the time of her death. As the Court of Appeals for the Third Circuit rightfully noted, this formula is not a method of determining the portion which will produce an income that the decedent directed, but is a method which will require the corpus to be invaded to make up the difference between the income yield and the monthly income bequeathed to the widow. Such a formula does fly into the face of the congressional intent concerning terminable in-

terests in marital deduction problems and would allow this portion of the decedent's estate to escape Federal Estate tax both on the death of the decedent and on the death of decedent's spouse. This is *not* the *Koch* case, where the taxation on the decedent's interest is merely postponed until the death of the decedent's widow.

B. In the instant case, the decedent, G. Ashburn Koch, directed his Trustee to invest his trust estate so as to return at least four per cent (4%) income, an amount of income which would produce more than twice the monthly payments bequeathed to the widow; whereas, in the *Northeastern* case no directions were given to the Trustee and because of the insufficiency of the trust estate, the trust estate would be unable to produce the amount of monthly income bequeathed to the widow at any reasonable income percentage without the invasion of the trust estate.

C. The will, in the *Northeastern* case, allowed the executor to invade the principal of the trust for illness and financial emergencies, an unknown factor, as pointed out by the Appellate Court. In the *Koch* case no such discretion was given the executor, a further indication that the trust fund would rise and fall with the market to await full taxation at the death of the widow.

D. In the *Koch* will the widow was to get *all* of the income from *all* of the trust after December 1, 1964, whereas the will in the *Northeastern* case had no such direction.

II.

The Decision of the Court Below Was Correct.

The purpose of the marital deduction was to extend to married taxpayers in commonlaw states the advantages of residents of community property jurisdictions by permitting a surviving spouse to acquire free from Federal

Estate taxation one-half of the adjusted gross estate of a deceased spouse. A marital deduction may be disallowed if there are terminable interests, that is, interests which will terminate or fail on the lapse of time or on the occurrence of some contingency.

> "* * * Generally speaking, the 'terminable interest' concept was devised for the purpose of assuring that if the property bequeathed to the spouse was to be excluded from the gross estate of the decedent, it would be adequately integrated in the spouse's estate so that on her death, it would not escape the death tax a second time. 'The basic principle . . . is that the spouse first to die shall be permitted to pass on to the surviving spouse free of estate tax up to one-half of his or her estate provided only that the terms of the transfer are such that this property will be taxable in the estate of the surviving spouse.' "
>
> *Dougherty* v. *United States,* 292 F. 2d 337.

The Committee Reports accompanying the Revenue Act of 1948 discussing the marital deduction stated in part:

> ". . . This provision is designated to allow the marital deduction for such cases where the value of the property over which the surviving spouse has a power of appointment will (if not consumed) be subject to either the estate tax or gift tax in the case of such surviving spouse."[1]

As pointed out herein, there is no terminable interest in this case. The entire amount of the trust estate created by G. Ashburn Koch will ultimately be taxed in the estate of his widow, Mary Jane Koch, at her death.

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1. Senate Report No. 1013, 80th Cong., 2nd Sess., 2 U. S. C. Cong. & Admin. News (1948), p. 1238.

III.

No Important Federal Question Is Involved.

Petitioner, in its brief, has little to say as to why this minor issue should be considered by and take the time of this Court. On page six (6) of its brief Petitioner says:

> "The Treasury Regulation here in question has presumably discouraged most estate planners from using bequests of a fixed amount of income plus a general power of appointment."

Thus, by its own petition, the Government admits that the number of people who would be affected by the *Koch* decision is very small. The language of the statute which is in question has no general application in any other situation, context or statute. Therefore, the impact of the decision is of great interest to Mary Jane Koch, the widow, but of only academic interest generally.

If the Government feels the decision of the *Koch* case is wrong it, of course, can request Congress to amend the statute. It should not ask this Court to do its amending for it.

The Treasury's definition of the term "specific portion" is void as an attempt to make law, rather than to carry into effect the express intent of Congress in liberalizing the marital deduction concept. As set out in *Gelb* v. *Commissioner of Internal Revenue,* 298 F. 2d 544 (C. A. 2d):

> ". . . The liberalization in the provision as to trusts, made in the 1954 Code and applied to earlier years by the Technical Amendments Act, was evidently designed to permit certain normal testamentary dispositions without the total forfeiture of the deduction that the 1939 Code had occasioned in some instances. That Congress gave a fractional interest as an example

of a 'specific portion' does not warrant a construction that Congress did not mean to include other instances fairly within the language and the underlying policy. We disapprove Regulations 105, § 81.-47a(c), (3) (1954 Code—Regulation 20.2056(b)-5(c)) insofar as it would limit a 'specific portion' to a 'fractional or percentile share.' "

The bequest of a dollar amount per month from a trust of a size more than adequate to provide such dollar amount is obviously a bequest of income from a "specific portion" of such trust.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that this Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 488

UNITED STATES OF AMERICA, PETITIONER

v.

THE CITIZENS NATIONAL BANK OF EVANSVILLE, AS EXECUTOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY MEMORANDUM FOR THE UNITED STATES

1. Respondent states that "The basic principle underlying the marital deduction is that the spouse first to die shall be permitted to pass on to the surviving spouse, free of estate tax, up to one-half of his or her estate, *provided only that the terms of the transfer are such that this property will be taxable in the estate of the surviving spouse.*" (Br. Op. 3, emphasis added.) Building on this hypothesis, it then argues that the decedent's bequest to his widow qualifies for the marital deduction because the trust corpus will, by virtue of her general power of appointment over the trust assets, be included in her estate at her death. (See 1954 Code, § 2041, providing that a

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decedent's estate includes property over which she has a general power of appointment.)

Respondent has, however, misconceived the basic rationale of the marital deduction. If, as respondent contends, Congress had intended to grant a marital deduction to a decedent whenever assets in trust would be included in his surviving spouse's gross estate, then § 2056(b)(5)—the statutory provision here in question—would have provided for such a deduction in cases where the decedent left his widow only a general power of appointment over the trust corpus. However, that provision permits a marital deduction for trust assets only when the decedent has given his surviving spouse both a general power of appointment *and* "all the income" from the trust assets (or "all the income from a specific portion thereof") "for life," "payable annually or at more frequent intervals." § 2056(b)(5).

As explained in detail in our petition (Pet. 7–8), Congress intended the marital deduction to equalize the estate tax situation of decedents in common law and community property States.[1] Since, in a community property jurisdiction, the surviving spouse acquires absolute ownership over her one-half share of the community property, Congress declined to grant a marital deduction to a decedent in a common law state who left his surviving spouse an interest which was less than virtual ownership of trust assets. Thus

[1] Although inconsistent with its earlier statement that the "basic principle underlying the marital deduction" is to prevent taxation in both spouses' estates (Br. Op. 3), respondent concedes that the "purpose of the marital deduction was to extend to married taxpayers in common-law states the advantages of residents of community property jurisdictions" (Br. Op. 4).

the fact that the surviving spouse is given an interest (such as a general power of appointment) which is sufficient to require inclusion of the assets in her gross estate will not qualify the bequest for the marital deduction.[2]

2. Respondent's misunderstanding of the purpose of the marital deduction also leads it to urge an irrelevant ground for distinguishing the result in the instant case from the contrary result reached by the Third Circuit in *Northeastern Pennsylvania National Bank & Trust Co.* v. *United States* (Pet. App. B, pp. 23–46). Respondent urges that the marital deduction was properly denied in the *Northeastern Pennsylvania* case because invasion of corpus for the benefit of the widow in that case was probable, whereas in this case it is improbable. In fact, the actual or assumed existence of a power in the trustee to invade corpus in favor of the surviving spouse is completely immaterial in determining whether she has received a sufficient interest in the trust property to qualify for the marital deduction.

If the decedent had left the property here in question to his widow absolutely, it would undisputably have qualified for the marital deduction (even though she might prevent its inclusion in her estate by consuming it during her life). See, *e.g.*, 1954 Code, § 2056(a). If, however, he chooses to leave it in trust he must *at least* give her the right to all the income from the property (or all the income from a specific portion thereof) plus a general power of

[2] In such a case the Code ameliorates the burden of taxing the assets in both the husband's and the wife's estates by granting the second decedent a credit for the estate tax paid by the first decedent on the same assets. 1954 Code, § 2013.

appointment over it. 1954 Code, § 2056(b)(5). There is nothing in the Code to prevent him from giving her or a trustee greater power over the trust property exercisable solely in her favor. For example, the trust would still qualify for the marital deduction even if the decedent had also given his widow the power to withdraw the corpus at her discretion, or if he had given the trustee the power to pay the corpus to her at its discretion, or if he had directed the trustee to terminate the trust at the end of five years and pay all of the corpus to his widow.

Therefore, the bequest in the *Northeastern Pennsylvania* case could not have been disallowed because the trustee might have invaded corpus to maintain the stated payments to the widow. In fact, the Third Circuit acknowledged that the two cases were indistinguishable with respect to the issue presented and denied a marital deduction because it disagreed with the Seventh Circuit's holding in the instant case (Pet. 38). Consequently, review by this Court is necessary in order to resolve the direct conflict between the circuits on this important question in the administration of the Internal Revenue laws.

Respectfully submitted.

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